

BEFORE THE
UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Market Dominant Product Prices
Inbound Market Dominant Multi-Service Agreements
with Foreign Postal Operators 1

Docket No. R2016-1

Korea Post–United States Postal Service
Multi-product Bilateral Agreement (MC2010-35)
Negotiated Service Agreement

PUBLIC REPRESENTATIVE COMMENTS ON
POSTAL SERVICE NOTICE CONCERNING
TYPE 2 RATE ADJUSTMENT AND KOREA POST
NEGOTIATED SERVICE AGREEMENT

(November 23, 2015)

The Public Representative hereby provides comments pursuant to Order No. 2819.¹ In that Order, the Commission established the above referenced docket to receive comments from interested persons, including the undersigned Public Representative, on a Postal Service Notice of a Type 2 rate adjustment in conjunction with a new market dominant international negotiated service agreement (NSA).²

The Notice concerns the inbound portion of a bilateral agreement with Korea Post to be included within the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 (Multi-Service Agreements) product. The inbound portion of the agreement with Korea Post (Korea Post 2016 Agreement) establishes negotiated rates for inbound letterpost in the form of small packets with delivery scanning (a.k.a., ePackets). Notice at 3.

Included as Attachment 1 to the Notice is an application for non-public treatment of materials filed under seal. A public (redacted) version of the Korea Post 2016

¹ Order No. 2664, Notice and Order Concerning Type 2 Rate Adjustment and Functionally Equivalent Agreement, August 14, 2015.

² United States Postal Service Notice of Type 2 Rate Adjustment, and Notice of Filing Functionally Equivalent Agreement, August 13, 2015 (Notice).

Agreement is provided in Attachment 2.³ The Postal Service also filed under seal the full (unredacted) text of the Korea Post 2016 Agreement and a supporting financial model estimating the volume, revenue, costs and contribution of the Agreement.

In Order No. 549, the Commission approved the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 product, and included the Strategic Bilateral Agreement Between United States Postal Service and Koninklijke TNT Post BV and TNT Post PakketSERVICE Benelux BV (TNT Agreement) and the China Post Group—United States Postal Service Letter Post Bilateral Agreement (China Post 2010 Agreement) within the product.⁴ Subsequently, the Commission determined that bilateral agreements with the China Post Group, Hongkong Post, Singapore Post Limited, the Australian Postal Corporation, the Canada Post Corporation, Korea Post, and the Netherlands Royal PostNL BV should be included within the Multi-Service Agreements product.⁵

In Order No. 2148, the Commission established the TNT Agreement and the China Post 2010 Agreement as baseline agreements that can be used as alternatives in future functional equivalence comparisons, with the selection of either agreement in any future multi-service agreement filing left to the option of the Postal Service.⁶

The Korea Post 2016 Agreement is the successor to an existing bilateral agreement with Korea Post (Korea Post 2014 Agreement), which expires December 31,

³ The Public Representative observes that the Postal Service's Notice did not include a copy of the Governors' Decision establishing prices and classifications for the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 product. Nor does the Postal Service's initial request to add this product to the market dominant product list include a Governors' Decision. See Request of United States Postal Service to Add Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators to the Market Dominant Product List, Notice of Type 2 Rate Adjustments, and Notice of Filing Two Functionally Equivalent Agreements (Under Seal), Docket Nos. MC2010-35, R2010-5, and R2010-6, August 13, 2010.

⁴ See Order No. 549, Order Adding Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 to the Market Dominant Product List and Approving Included Agreement, Docket Nos. MC2010-35, R2010-5 and R2010-6, September 30, 2010.

⁵ See <http://www.prc.gov/mail-classification-schedule>, Mail Classification Schedule, June 4, 2015 (with revisions through: November 2, 2015), section 1602.3.5, for a list of market dominant multi-service agreements currently in effect.

⁶ Order No. 2148, Order Granting, in Part, Motion for Partial Reconsideration of Order No. 1864 and Modifying, in Part, Order No. 1864, Docket No. R2013-9, August 11, 2014, at 7.

2015.⁷ The Postal Service states that the proposed Effective Date for the Korea Post 2016 Agreement is January 1, 2016. Notice at 3. The Korea Post 2016 Agreement is to remain in effect until December 31, 2016, unless terminated sooner. *Id.*, Attachment 2 at 6 (Article 22).

The Postal Service states that the negotiated prices in the Korea Post 2016 Agreement will result in an “improvement over default rates established under the Universal Postal Union (UPU) Acts” for inbound letter post items. *Id.* at 1. The Postal Service also identifies four operational changes in the Korea Post 2016 Agreement that it states “should enhance the performance of mail preparation, processing, transportation and other functions related to the delivery services provided for Letter Post items under the agreement.” *Id.* at 4.

Pursuant to Order No. 2148, the Postal Service identifies the China Post 2010 Agreement as the baseline agreement for functional equivalence comparisons. *Id.* at 1. In this regard, the Postal Service maintains that the Korea Post 2016 Agreement is “functionally equivalent to the China Post 2010 Agreement filed in Docket No. R2010-6.” *Id.* at 8. Therefore, the Postal Service requests that the Korea Post 2016 Agreement be included within the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 (MC2010-35) product. *Id.* at 9.

COMMENTS

The Public Representative has reviewed the Postal Service’s Notice, and the Korea Post 2016 Agreement and supporting financial model filed under seal with the Notice. The Public Representative also reviewed the financial model for the China Post 2010 Agreement filed under seal in Docket No. R2010-6.

Based upon that review, the Public Representative concludes that the Korea Post 2016 Agreement is functionally equivalent to the baseline China Post 2010

⁷ See Order No. 1864, Order Approving an Additional Inbound market Dominant Multi-Service Agreement with Foreign Postal Operators 1 Negotiated Service Agreement (with Korea Post), Docket No. R2013-9, October 30, 2013; *see also* Order No. 2235, Order Approving Additional Inbound Market Dominant Multi-Service Agreement with Foreign Postal Operators 1 Negotiated Service Agreement, Docket No. R2015-1, October 31, 2014; *and* Order No. 2287, Order Approving Modification to Existing Agreement, December 12, 2014.

Agreement. Moreover, the Public Representative finds that the Korea Post 2016 Agreement is likely to improve the net financial position of the Postal Service. However, the Postal Service provides no discussion, documentation or analysis to support its claim that the identified operational changes “should enhance” the operational performance of the Postal Service. As a result, the Public Representative cannot evaluate the expected impact, financial or otherwise, of such changes on the Postal Service’s operational performance during the term of the Agreement.

Functional Equivalence. In support of its claim as to functional equivalence, the Postal Service states that the terms of the Korea Post 2016 Agreement fit within the proposed Mail Classification Schedule (MCS) language for Inbound Market-Dominant Multi-Service Agreements with Foreign Postal Operators 1 product. *Id.* at 8. The Postal Service also asserts that the Korea Post 2016 Agreement and the China Post 2010 Agreement are constructed from a similar template and contain many similar terms and conditions. *Id.* Importantly, the Postal Service states that both agreements provide rates for the delivery of inbound small packets with delivery scanning tendered to the Postal Service from the territory of each foreign postal operator. *Id.* Moreover, the financial models used to project costs and revenues for the duration of the each of the agreements are similar. *Id.*

The Public Representative’s review of the supporting financial models for the Korea Post 2016 Agreement and the China Post 2010 Agreement reveal that the Korea Post 2016 Agreement and the China Post 2010 Agreement share similar cost and market characteristics. In terms of market characteristics, both agreements establish negotiated rates for inbound ePackets tendered by both foreign postal operators.⁸ In terms of cost characteristics, both financial models develop unit costs for mail processing, delivery, domestic transportation, and all other domestic costs associated

⁸ Compare the Service Descriptions and Stream codes in the China Post 2010 Agreement financial model, Excel file (Non-Public) China_MD_IB_2010.08.09, worksheet tab 12_Pieces-Wgt & TDues_Rates, columns B and C, and the Service Descriptions and Stream codes in the Korea Post 2016 Agreement financial model, Excel file (Non-Public) Korea_MD_IB_2015_FINAL, worksheet tab 12_Pieces-Wgt & TDues_Rates, columns B and C.

with inbound ePackets.⁹ The Public Representative therefore concludes that the Korea Post 2016 Agreement is functionally equivalent to the China Post 2010 Agreement.

Statutory Criteria. Pursuant to 39 U.S.C. § 3622(c)(10), the statutory criteria for Commission review are whether a Postal Service agreement (1) will be available on public and reasonable terms to similarly situated mailers, (2) either improves the net financial position of the Postal Service or enhances the performance of operational functions, and (3) will not cause unreasonable harm to the marketplace. With respect to criteria (1) and (3), the Postal Service makes reasonable arguments that such criteria are not implicated by the Korea Post 2016 Agreement. *Id.* at 2-5.

With respect to criterion (2), the Postal Service's financial model presents a comparison of the cost coverage of Korea Post 2016 Agreement based upon the negotiated rates and the UPU terminal dues. The Postal Service relies on such a comparison to support its claim that the negotiated rates for inbound ePackets entered pursuant to the Korea Post 2016 Agreement improves the net financial position of the Postal Service.

In this regard, the Public Representative finds that the cost coverage at the negotiated rates exceed the cost coverage at the UPU terminal dues. Moreover, the cost coverage of the Korea Post 2016 Agreement indicates that revenue generated from the negotiated rates exceeds the attributable costs estimated for the Agreement. Thus, the Public Representative concludes that the negotiated rates in Korea Post 2016 Agreement "improve the net financial position of the Postal Service." 39 U.S.C. § 3622(c)(10)(A)(i).

However, the Public Representative observes that to make its comparison, the Postal Service's financial model uses the 2016 base terminal dues for inbound letterpost items exchanged between designated postal operators in the target system as

⁹ Compare the cost characteristics in the China Post 2010 Agreement financial model, Excel file (Non-Public) China_MD_IB_2010.08.09, worksheet tabs 03_Dom_Tran_Inputs and 07_Stream_Unit_Cost_Inputs, and the cost characteristics in the Korea Post 2016 Agreement financial model, Excel file (Non-Public) Korea_MD_IB_2016, worksheet tabs 03_Dom_Tran_Inputs and 07_Stream_Unit_Cost_Inputs.

of 2010 and 2012, and operators in the target system prior to 2010.¹⁰ Such terminal dues are not the default rates that would be paid by Korea Post for inbound letterpost tendered to the Postal Service in the absence of the Korea Post 2016 Agreement. Moreover, the Postal Service's use of the 2016 base terminal dues in its financial model results in the lowest possible cost coverage for purposes of comparison, thereby increasing the difference between the cost coverage at the negotiated rates compared to the cost coverage at the UPU default rates.

Given that revenue is expected to exceed the attributable costs of the Korea Post 2016 Agreement, the Postal Service's use of the 2016 base terminal dues to develop the cost coverage at the default rates for purposes of comparison with the cost coverage at the negotiated rates does not change the conclusion that the negotiated rates in the Korea Post 2016 Agreement improve the net financial position of the Postal Service. In its financial model, however, the Postal Service should have used the 2016 provisional quality of service linked terminal dues rates applicable to inbound letterpost exchanged between designated operators in the target system as of 2010 and 2012, and operators in the target system prior to 2010.¹¹ The 2016 provisional quality of service linked terminal dues are the default rates that would be paid by Korea Post for inbound letterpost tendered to the Postal Service in the absence of the Korea Post 2016 Agreement.

This Public Representative has previously expressed concern about the Postal Service's use of the UPU base terminal dues rather than the provisional terminal dues (as appropriate) in its financial model.¹² In response, the Commission directed the Postal Service to "ensure that the default rates used to demonstrate improved net financial position under an agreement are, in fact, the rates that would otherwise, in the

¹⁰ The Postal Service's financial model cites UPU International Bureau (IB) Circular 108, July 1, 2015. The terminal dues rates used by the Postal Service are found in Table 1.2., in the columns for items and kilograms headed "Base TD rates in SDR for 2016" for the "United States of America." The United States became a target system designated operator prior to 2010.

¹¹ For the 2016 default rates, refer to UPU IB Circular 108, July 1, 2015, Table 1.2, in the columns for items and kilograms headed "Provisional QS linked TD rates in SDR for 2016" for the "United States of America."

¹² Public Representative Comments on Postal Service Notice Concerning Type 2 Rate Adjustment and Hongkong Post Negotiated Service Agreement, Docket No. R2015-5, September 14, 2015, at 5-6.

absence of the agreement, be paid by the foreign postal operator during the agreement's term.”¹³

The Public Representative therefore respectfully reiterates its requests that in future dockets considering the addition of inbound market dominant multi-service agreements, the Commission again direct the Postal Service to develop its comparison of the cost coverage at the default rates using the UPU terminal dues rates that would otherwise be paid by the foreign postal operators during the term of the proffered agreements— assuming the absence of such agreements.

To satisfy criterion (2), the Postal Service also identifies, pursuant to 39 C.F.R. § 3010.42(g), four operational changes in the Korea Post 2016 Agreement that it claims “should enhance” the performance of mail preparation, processing, transportation or other functions. Those changes are:¹⁴

- revised rates and terms for small packets with delivery scanning;
- improvements to labels; and
- use of Postal Service barcodes to facilitate sortation; and
- sortation recommendations.

Commission rule 3010.42(g) further requires “a discussion of the nature and expected impact of each enhancement.”

The Postal Service's claim that the identified operational changes “should enhance” the operational performance lacks substance. The Postal Service provides no discussion, or analysis, of the nature and expected impact of each purported enhancement as required by the Commission's rule. 39 CFR 3010.42(g). As such, the Public Representative can only conclude that the identified operational changes are included as through-away items, intended to address in the most minimal fashion possible the Commission's rule, given the absence of any discussion or analysis

¹³ Order Approving Additional Inbound market Dominant Multi-Service Agreement with Foreign Postal Operators 1 Negotiated Service Agreement (with Hongkong Post), Docket No. R2015-5, September 17, 2015, at 8.

¹⁴ Notice at 3-4.

concerning impact. Therefore, the identified operational changes cannot be used to satisfy the requirements of 39 U.S.C. § 3622(c)(10)(A)(ii).

The Public Representative respectfully submits the foregoing comments for the Commission's consideration.

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